Market Dynamics

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Who Needs A Second Opinion On A Stock?

Performance Management System

Portfolios heavy with under-performing stocks almost never outperform the market. Ignat's Law

"you cannot make money in a stock by yourself."

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Experience indicates that all investors should always seek out a second opinion on a stock before accepting the opinion to buy, sell or hold from anyone in a sales capacity. Many of the opinions expressed in this report are drawn from the observations of Wall Street analyst's rating changes on stocks that were covered in the daily TPARC reports.

The individual investor may receive the analyst's rating change second hand rather than directly from the analyst. There are many reasons why an analyst may change his rating on a stock and some of these factors may be aimed at benefits to the brokerage firm rather than benefits to the investor. Some analysts may be inexperienced and of an unknown track record of success. Some analysts may be responding primarily to the spin about the company provided by management or investor contacts or PR people. These are just a few of the reasons why investors need to seek out a second opinion regarding the recommendations of a Wall Street analyst.

This ignores the fact that a Wall Street analyst can be completely wrong in his fundamental appraisal of a stock. There are no "hard and fast" rules for developing an investment rating on a stock and given the subjective nature of the analysis, a second opinion is called for.

There is also the situation where several analysts follow a stock and they may have different opinions about the investment merits of the stock. The investment opinions may range from "strong buy" to "strong sell" or be somewhere in between. Sometimes conflicting investment opinions can be reported on the same day. The investor surely needs a second opinion when there is disagreement among the analysts who follow the stock. A second opinion helps to sort out the difference of opinion and make an informed decision.

Sometimes an analyst will make a change in the investment opinion based on short-term considerations or rumors that cannot be confirmed by a second opinion on the trend of the stock. The long-term investor needs to be especially "on guard" about responding to short-term factors or planted rumors that may prove to be false.

The best and most effective source of a second opinion on an analyst's rating change is to investigate the long-term trend of performance shown by the stock on a chart. The long-term point and figure charts of relative strength remove the random noise from the price data and the influence of the overall market is removed as well. These charts show the movement on the chart that is specific that that stock. It is the direction of the long-term trend of performance that provides the second opinion on the analyst's opinion about the stock.

If the trend is down it is best to ignore the "buy" and "hold" opinions reported by the analysts. If the trend is definitely up, the analyst's 'sell" recommendations may be ignored and the "buy" recommendations implemented. There is also the situation where there is no definite trend showing at all and it is probably best to avoid such trend-less stocks.

The second opinions provided by the long-term PnF charts of relative strength are most helpful when dealing with the pervasive recommendations to "hold" a stock. This is especially true when an analyst reports a downgrade on the rating of a stock and lowers his opinion to "hold" or to "market perform" or to "neutral." The downtrend on the chart removes any excuse to hold the stock when the trend is definitely down.

It should be remembered that you cannot make money in a stock by yourself. You will share the experience of the other buyers and holders of the stock, so it is important to investigate whether they are winning or losing. This second opinion is easy to develop and will enhance the investor's confidence in his own decision making and investment performance.

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